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American Woman's Society of Certified Public Accountants

American Society of Women Accountants

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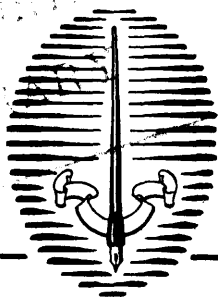
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THE C.P.A. WOMAN



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A P R I L 1 9 4 9

Official Publication

**AMERICAN WOMAN'S SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS
AMERICAN SOCIETY OF WOMEN ACCOUNTANTS**

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46th
Year

IAS

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EDITORIAL

SPRING CONFERENCE

The Joint AWSCPA/ASWA spring conference will be held at the Book-Cadillac Hotel in Detroit May 21-22 and will be combined with the Tenth Anniversary of the Detroit chapter. Detroit is planning to give everyone who will come a good time.

ANNUAL MEETING

The joint annual meeting of the two societies will be held at the Huntington Hotel in Pasadena, California, October 27-29, just preceding the American Institute convention. More details will be given later but you can rest assured that it will be worth your while to take advantage of this double bill.

SURPLUS OR RESERVE?

In an article in the July issue of *The Accounting Review*, George F. Wyman, who is associated with the central headquarters of NACA as editor, asks, "Is surplus the reserve?"

He raises the thought that it may not be within the province of a corporation to hold earnings in its accounts except as, in the judgment of the management, their retention may serve a purpose. This, he says, raises the further thought that such may turn out to be not surplus at all but simply a reserve, perhaps the only reserve appro-

priate to corporate accounting.

He suggests that if the idea proves to be sound it would present a solution of two of the most difficult problems of statement terminology. The word "reserves," now used on both sides of the balance sheet in a number of senses, would disappear except as a descriptive caption for retained earnings in the net worth section. At the same time the word "surplus," which has long troubled accountants and misled lay readers, would disappear from accounting vocabulary.

PUBLIC RELATIONS

In an article in *The Certified Public Accountant*, Charles E. Noyes, director of public information for the American Institute of Accountants, comments that if the medical practitioner were known only as John Jones, M.D., it is doubtful if the medical profession would ever have achieved the universal recognition which goes with the title of "doctor."

The legal profession has tried to compensate for the lawyer's lack of a corresponding title by encouraging the use of "Esq." after the name of its members in addressing them or referring to them.

The accountant is even more handicapped in that so relatively few people even know what the initials "CPA" stand for or what the possession of the certificate signifies.

Mr. Noyes concludes: "Full public acceptance of CPA as a professional designation will come with wider public experience of the professional qualifications of the certified public accountant. Since relatively few people have occasion to use the services of a CPA in business, this public experience depends to a considerable extent on the activities of certified public accountants in community and civic affairs, and individual contacts.

"All this adds up to the fact that every certified public accountant should make it his personal business to see that more people do understand what the CPA certificate means, and what a CPA does."

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TAX NEWS

TENNIE C. LEONARD, C.P.A., Memphis, Tennessee

PROPOSED TAX TRIBUNAL

Particularly appealing to the certified public accountant is the idea of a Tax Settlement Board to be set up for the adjustment of tax controversies between the Treasury Department and taxpayers. This Board, which would consist of 25 men, independent of the Treasury, has been proposed by Representative Mills (D) of Arkansas in his bill, H.R. 2983. Mr. Mills is an influential member of the Ways and Means Committee which drafts legislation dealing with taxes in the House of Representatives.

Under present procedure, when a taxpayer is presented with a claim for more taxes, he is entitled to a conference with the Internal Revenue Agent in Charge in his district. Failing to reach an agreement with the Agent, the taxpayer has the right to appeal to the regional Technical Staff for further hearing, and not satisfied with the settlement he is offered by the Staff, he may either appeal to the U. S. Tax Court, or pay the tax demanded by the Treasury, and file suit for refund in the Federal District Court or Court of Claims.

Until the taxpayer takes his case to the Tax Court or to the District Court, he is negotiating with employees of the Bureau of Internal Revenue, and probably feels they are inclined to favor the views of the examining agent who first proposed the tax deficiency. The Tax Settlement Board would give the taxpayer an opportunity to present his case to others than those under the influence of the Bureau, without the necessity for hiring an attorney. All too often the Technical Staff offers to reduce a proposed assessment of additional taxes by the amount it estimates it will cost the taxpayer to employ the counsel necessary to have his case heard by the courts, if the small reduction will result in an agreement by the taxpayer.

The taxpaying public may view the discussion about the need for a Tax Settlement Board as another skirmish between the legal and accounting professions in their efforts to dominate tax practice. However, if Congress passes the pending legislation (H.R. 3113), sponsored by the attorneys, accountants will be barred from practice before the the Tax Court, and they

have never been permitted to practice before the District Courts.

Since it is estimated that accountants prepare 90% of the income tax returns not prepared by taxpayers themselves, and almost always represent their clients in the early stages of tax cases, it seems likely they will represent them before the Tax Settlement Board, if that body is established, and H.R. 2983 was written with that in mind, although it would be possible for taxpayers to represent themselves before the informal Board.

The Treasury Department is apparently lukewarm on the idea, expressing the opinion that the proposed Board would make tax settlements slower, that the 25-man Board would not be able to handle the 13,397 tax disputes heard by the Technical Staff during the fiscal year 1947-48. However, the Technical Staff was able to reach agreements on only 4,264 of the cases it heard, and proponents of the Mills bill argue that a much higher percentage of settlements would be arrived at by a group not under the influence of the Bureau of Internal Revenue.

WOMAN JUDGE REMAINS ON TAX COURT

Miss Marion J. Harron, Judge of the Tax Court of the United States, whose term expired June 2, 1948, has been reappointed to another term of twelve years and her confirmation by the Senate is expected. Miss Harron was originally appointed to the Tax Court, then the Board of Tax Appeals, in 1936, when she was 33 years old.

TELEVISION AND TAXES

Two states have already applied taxes to television. Kentucky is levying an admissions tax on taverns showing television and Pennsylvania is requiring them to take out licenses as motion picture exhibitors. So far the Bureau of Internal Revenue has refused to declare that television is entertainment. We hear the point is debatable.

And speaking of admissions—the Bureau struck a blow for equal rights (and higher taxes) when it ruled that when women are charged lower admission rates than men, the tax must be computed on women's admissions at the higher admission rate for men. The First Circuit has sustained the Commissioner. (Covey Gas & Oil, 12-2-48).

Entered as second-class matter December 19, 1945, at the Post Office at New York, N. Y., under the Act of March 3, 1879.

COAST-TO-COAST NEWS

VIRGINIA THRUSH, Toledo, Ohio

ATLANTA

Pollard Turman spoke before the study course preceding the January meeting on the subject of *Contracts*. Mr. Turman is assistant to the president of J. M. Tull Metal & Supply Co. Harold W. Moorhouse, professor of economics, University of Georgia, was the dinner meeting speaker. His subject was *The Trend of the Federal Budget*.

CHICAGO

Maurice L. Cohen, general insurance broker and representative of the Mutual Life Insurance Company of New York, addressed the society in January on *Increased Profit Through Improving Employee Relations*. He stressed the need for management to provide adequate retirement and benefit programs.

Careers for Women in Financial Institutions was the topic of Genevieve Decker's talk in February. Miss Decker is vice president of the First Federal Savings and Loan Association of Chicago.

CLEVELAND

What is Ohio Personal Property Tax? was discussed at the February meeting. Katherine Pfeifer, Margaret Breen, Eleanor Clark and Frances Bogovich, all members of the education committee, led the discussion.

COLUMBUS

Roger K. Powell, tax attorney, spoke in December on the *Income Tax*, covering capital gains and losses, an outline of phases of income tax accounting and the history of community tax rights.

The February speaker was Harold Schellinger, public relations director with Byers and Bowman Advertising Agency; his topic, *Public Relations Down to Earth*.

DETROIT

Over 150 persons attended the January Public Relations meeting, at which Donald M. Russel, CPA, presented his *Interpretation of Financial Statements*. Mr. Russel stressed the need for making statements comprehensible to the non-accountant.

Helpful Hints in Preparation of Federal Tax Returns were presented by John Raymond at the February meeting, his third address before the group in three years.

INDIANAPOLIS

Marjorie Dobson, assistant city librarian in Indianapolis, presented several Christmas stories at the December meeting. As is their custom, members prepared 200 Christmas packages for the needy.

Dr. George Rice, teacher of speech at Butler University, is conducting classes for chapter members in *Public Speaking in Business* under the sponsorship of the education committee.

Howard Green, vice president of Kingan & Company, spoke on *Prices, Profits and Private Enterprise* in January.

The Fiftieth Anniversary of the Merchants' Association in Indianapolis was the topic of the talk given in February by Murray Morris, manager of the Merchants' Association in Indianapolis.

Ida Broo was responsible for the organizing of a new chapter in Louisville. Thirty-three members of the local chapter took part in the installation.

MUSKEGON

Payroll Methods were discussed by Arthur W. Potter, manager of the payroll division of Shaw-Walker Corporation, at the February meeting. Various payroll systems were evaluated in the discussion period which followed.

R. C. Nichols, with the Daniels Corporation, spoke at the January meeting on *Posture* and its importance in the prevention of fatigue.

NEW YORK

R. H. Willson, a principal of the accounting firm of Haskins & Sells, addressed the January meeting on *Accounting for Industrial Loan Companies*.

Through the courtesy of Jennie Palen, members attended a meeting of the Soroptimist Club to hear Dora Lewis tell about her recent trip to Japan.

New Horizons in Political Education were presented by Lois Black Hunter in February.

SAN FRANCISCO

Marjorie Hitch, with the international department of the Bank of America, spoke at the January meeting.

Tax Prospects for 1949 was the timely subject covered by Stanley F. Surrey in
(Continued on page 9)

'OF RECKONINGS AND WRITINGS'

By LOIS WILLIAMSON SMALEY

This delightful article was written by Mrs. Smalley while she was still Lois Williamson and a student at the University of California two years ago. She and her husband are now living in Sydney, Australia, where she is on the staff of a public accounting firm.

Mrs. Smalley was the student who received the \$100 scholarship which the Los Angeles chapter ASWA presented in 1947 as part of its educational program. It is obvious that they made a wise selection.

PART I

"The part which the forefathers have played in the work of their children is too often forgotten."

Paul Viollet, *Cambridge Modern History*, viii, p. 711.

The history of accounting is rarely mentioned in the countless number of books published on the subject, and the misconception that accounting is a comparatively new field may be in part due to this omission. An examination of old records soon disavows any claim to originality made by 20th century authors, for the basic propositions of this science were established with the appearance of a complete system of double entry, and subsequent treatises have only registered their progress through the years.

The first necessity for a power to hold count and reckoning arose with the development of social life and especially the formation of states or sovereignties levying any form of taxation. Records of business transactions from an unknown period to about the 4th century before Christ have been discovered in Babylon, and, though history gives us little information on the subject, it may be safely assumed that methods of accounting were more or less developed among other ancient peoples of the world.¹ The art of account-keeping can be traced through all its stages by reference to an odd collection of records ranging from primitive clay slabs to the English Pipe Roll of the year 1130-1131.² None of these could be considered accounts in the modern sense of the word; however, a beginning was made, and the complete system

of double-entry was employed in the early 14th century, as evidenced by accounts maintained in Genoa in the year 1340.³

The first treatise on the art of bookkeeping was published in 1494 by one of the most celebrated mathematicians of his day, Luca Paciolo.⁴ His intention was to summarize existing knowledge of mathematics, but he closes this portion of his work with "complete instructions in the ordering of business." He entitles this section, "De computis et scripturis" ("Of reckonings and writings"), and states clearly that he will follow the method used in Venice at the time of writing.⁴ Though he makes no claim to offer any original contribution to the art, his superb handling of detail, combined with his intimate understanding of the subject, established him as the father of accounting.⁵

Seldom has a first book on a subject dominated its literature as did Paciolo's. The texts published during the next 150 years were "at best, revisions of Paciolo, at the worst, servile transcriptions without even the courtesy of referring to the original author."⁶ The significance of this dissertation may be better illustrated by a quotation from the writings of a later accountant, which reads as follows:

"Let those who vaunt the superior merits of other disciplines remember that this first presentation made by Paciolo was not crude and incorrect, but contained the essentials of bookkeeping as we know it today, despite the fact that it was written at a time when chemistry partook of the vagaries of alchemy, and medicine had more in common with the medicine man than it has even today.⁷ . . . Beneath the surface of the methodology which fills the little book is the unquestionable recognition of the fact that every transaction has a dual aspect . . . this is the most basic concept of bookkeeping."⁸

Thus it has been conceded that the principles upon which the famed method of Venice was developed have remained unchanged and become our heritage. From this beginning, we are able to determine those factors which were dominant in bringing out the latent possibilities of bookkeeping and accounting.

1. Richard Brown, *The History of Accounting and Accountants*, (London: T. C. & E. C. Jack, 1905), pp. 16-17.

2. Brown, *The History*, p. 41.

3. Brown, *The History*, p. 99.

4. Frater Luca Paciolo, *Treatise on Double-Entry Bookkeeping*, tr. Pietro Crivelli, (New York: Harper Bros., 1924), pp. 1-2.

5. A. C. Littleton, *Accounting Evolution to 1900*, (New York: American Institute Publishing Co., Inc., 1933), p. 1.

6. Littleton, *Accounting*, p. 4.

7. Littleton, *Accounting*, p. 4.

8. Littleton, *Accounting*, p. 78.

PART II

"Let no man venture into large business while he is ignorant of the method of regulating books; never let him imagine that any degree of natural abilities will enable him to supply this deficiency, or preserve multiplicity of affairs from inextricable confusion."

Samuel Johnson, *A Dictionary of the English Language*, Preface, Vol. 1, London, 1755.

The one factor which instigated the evolution of isolated notations into a homogeneous system was necessity. No advancement was made as long as the account-books were intended solely for the private information of the trader. Partners in a business, on the other hand, required a record of the entire course of trading so as to apportion profits, and it is in this necessity that we find the prime motive for creating a system of bookkeeping.⁹

The method of Venice, as described by Paciolo, is illustrative of an accounting system which met the requirements of the period. The points on which this system differs from modern practice are not due to a defective grasp of the principles involved; on the contrary, these peculiarities were the most convenient and practicable methods under the circumstances. "In none of the respects in which it differs from modern practice can it be said that later improvements would have recommended themselves to a merchant of these days."¹⁰

Let us take, for example, the number of account books and their usage in antiquity. Due to the lack of uniformity in monetary systems in the Middle Ages, it was first necessary to record the receipt of cash mediums in a book called the Memorial. The monetary unit was then converted to the one in which the books were kept; transferred into another book, the Journal; and then to a book of individual accounts referred to as the Ledger. Obviously, altered conditions have eliminated the need for the Memorial, but the Journal and Ledger are still in use today.¹¹

Of much interest is the procedure referred to as closing the books. Paciolo describes this "reporting from one book to another"¹² in minute detail, but the reason for the transfer, rather than the routine, is significant. Due to the peculiar treatment of undertakings as ventures instead of a continuous process of trading, the profit or loss on each venture was determined upon

its completion. Therefore, any periodic closing of expense and income accounts would have been of little value. Paciolo introduces this subject by saying, "... when you want to change book by reason of its being filled up, or because of the beginning of a new year, as it is customary to do in the best known places. The big merchants always observe this custom every year, specially in the New Year."¹³ One would have to be only vaguely familiar with accounting procedure to recognize that this custom, so quaintly expressed as arbitrary practice by a monk of five hundred years ago, prevails yet today.

A current topic of discussion among professional accountants is the "natural business year basis," a modern refinement in periodic closings. A natural year is defined as "the period of twelve consecutive months which ends when the business activities of the enterprise have reached the lowest point in their annual cycle."¹⁴ In modern times then, we again find necessity dominating the trend of thought, for the far-flung ownership of the corporation has necessitated the fine-line determination of profits made possible by the use of the natural business year.

A term conspicuously absent in Paciolo's writings is theory, although his treatment of the nominal and capital accounts shows that he had a very clear conception of their theoretical relation. An explanation for this omission is that "bookkeeping at that time was essentially a recording procedure and there was no necessity . . . for philosophic argument." When periodic reports began to receive attention, theory followed as a matter of course.¹⁵

Throughout Paciolo's treatise are both details that have a modern ring and details with the "flavor of mediaevalism."¹⁶ "Much of the interest of an examination of the old treatise *De Computis* lies in tracing how much of our modern practice is new, how much is old."¹⁷ The comparison of explanations regarding the sequence of business operations, as shown in the following tabulation, is representative of this uniqueness.

9. Littleton, *Accounting*, p. 155.

10. Brown, *History*, p. 119.

11. Brown, *History*, pp. 111-112.

12. Paciolo, *Treatise*, pp. 29-30.

13. Paciolo, *Treatise*, p. 82.

14. *Accountants Handbook*, ed. W. A. Paton, (New York: Ronald Press Co., 1943), p. 5.

15. Littleton, *Accounting*, p. 80.

16. Littleton, *Accounting*, p. 4.

17. Brown, *The History*, p. 111.

BOOKKEEPING PROCEDURES

As explained in 1494

The Inventory, what it is, and how it should be made by Merchants.

As explained in 1945

The Opening Journal Entry.

The opening entry or entries must provide

He must first of all write on a sheet of paper or in a book aside, all that he has in the world . . . and always begin with the things that are more valuable and easier to lose. These consist of ready cash, jewels, silver, etc., because estate, such as houses, lands, lakes, valleys, ponds, and the like, cannot be mislaid as are personal belongings and household goods.¹

Memorandum. . . . What is meant by it.

The memorandum, or according to some, the Loose Leaf or Household Expense Book, is a book wherein the merchant writes down all his transactions, small or big, just as they happen to come to him day by day and hour by hour, and in which is entered all transactions of sale or purchase and other matters, not leaving out an iota. . . . It is a good custom among true Catholics to first mark their books with that glorious sign from which all our spiritual enemies flee and at which all the infernal pack justly tremble; i.e., the Sign of the Holy Cross. . . .³

1. Paciolo, *Treatise*, p. 4.

3. Paciolo, *Treatise*, p. 4.

The Journal.

There are two expressions used in said Journal; one is called "Per," . . . always denotes debtor; the other "A", . . . always denoted the creditor. . . . At the commencement of each entry is always put the expression "Per", because the debtor must always be described first; and then, immediately after, the creditor . . . for the same day that gives birth to a debtor also sees the birth of a creditor.⁵

The way in which the items are transferred.

First the debtor's entry is placed on the left side and that of the creditor on the right. The year must be placed by itself in the margin facing the entry to which it refers . . . let us use the ancient letters, if only for the sake of more beauty. . . . You must write down two numbers at the side in the margin [of the Journal], one under the other. The one above denotes the debtor's entry and what page it occupies in the Ledger, and the one under indicates the page in said Ledger where the creditor's entry is posted. As you transfer from the Journal to the Ledger you will draw a single line across each item which will denote that said item was posted in the Journal.⁷

5. Paciolo, *Treatise*, p. 24.

7. Paciolo, *Treatise*, pp. 32-34.

How the balance of the ledger should be made. . . .

By the balancing of the book is meant the folding of a sheet of paper lengthwise, on the right hand of which is copied down the names of the creditors of the book, and on the left-hand the debtors. It is then seen if the sum of the debits is equal to that of the credits, and if so the book is in order. If one of the said sum totals exceeds the other it will denote that there is an error in your ledger, which, with diligence, it will be best for you to find with the ability of the intellect God has given you. . . .⁹

a record of the assets, the liabilities, and the proprietorship of the business at the time of organization. . . . investment may consist entirely of cash. . . . In some cases, however, the proprietor invests other property, such as land, a building, and merchandise . . . [first the] assets in the form of cash or assets that may reasonably be expected to be converted into cash in the near future . . . [followed by] assets that are of a permanent or fixed nature. . . .²

Business Papers—First Evidence of Transactions.

The business paper is made up at the time the transaction takes place . . . gives certainty to the understanding between the two parties to the contract . . . transferred to the accounting department, where they provide the information for the accounting entries . . . informs the accountant or the bookkeeper of the effect of the transaction on the accounts, and serves as his authority for making an accounting entry.⁴

2. Howard S. Noble, *Accounting Principles*, 4th Ed., (San Francisco: South-Western Publishing Co., 1945), p. 164.

4. Noble, *Principles*, p. 255.

The Journal.

The names of the accounts to be debited and credited and the explanation of the transactions are written in the Description column. The account to be debited is written first. The account to be credited is written on the following line. . . . The explanation of the transaction is written on the next line. . . .⁶

Posting.

Posting . . . consists in transferring each amount in the Debit Amount column of the journal to the debit side of an account, and transferring each amount in the Credit Amount column of the journal to the credit side of an account. The page in the journal from which the transaction is being posted is recorded in the folio column of the ledger. The date is entered in the date column on the debit side . . . consists of the year in small figures at the top of the first column . . . the number of the ledger page is entered in the Ledger Page column of the journal . . . shows that all details of posting this one item have been completed.⁸

6. Noble, *Principles*, p. 97.

8. Noble, *Principles*, p. 99.

The Trial Balance.

A test of the equality of the debits and credits . . . may be taken by listing the debit and credit balances of all the accounts. If the sum of the debit balances equals the sum of the credit balances, it is evident that the debits and credits in the ledger are equal.¹⁰

Transferring from one page to another.

If an account in the old book should be in the credit, you will make an entry for the amount in the debit; and thus you must do with a debtor . . . transfer to the Profit and Loss Account . . . where, summing up at once the debit and credit, you will be able to know your gain or loss. . . . This account must be finally closed and transferred to Capital.¹¹

9. Paciolo, *Treatise*, pp. 100-101.

11. Paciolo, *Treatise*, p. 82.

PART III

"Accounting originated in known circumstances in response to known needs; it has evolved and grown in harmony with its surroundings; its changes can be explained in terms of forces current at the time. Truly, then, accounting is progressive and relative. It came from definite causes; it moves toward a definite destiny."¹⁸

Accounting theory and practice have developed slowly and haltingly, but in steady stride with the principles and conduct of business. When business became specialized, so did accounting. When the determination of profits was no longer a matter of disbursements against income, cost accounting was evolved, and such abstract expenses as depreciation and amortization were considered. The problem of apportioning costs to the fiscal period was met with accruals and deferrals.

When the growing complicacy of business demanded more of the bookkeeper than a knowledge of arithmetic and ability to write, the responsibility of keeping the accounts could no longer be allocated to the slaves or agents, and accounting stepped forward as a professional field of endeavor. Textbooks were printed in rapid succession, "and again the university seriously undertook instruction in a subject which had fallen into academic disrepute."¹⁹ The Chartered Accountant appeared, and the bookkeeper was no longer depicted as a grey-haired bespectacled dullard.

The widespread adaptability of books of accounts introduced the aspect of commercialization in the field of accounting. The merchant of Venice ruled and columnized blank sheets of paper for his Journal and Ledger;²⁰ the modern printer furnishes ruled forms with standard headings in the columns. The early Venetian carried his ledger accounts forward to the page following "immediately after all the others";²¹ loose-leaf practices have provided a clarifying sequence of accounts and opened the door for such present-day companies as Reynolds & Reynolds, Inc., which furnish printed journal and ledger sheets in a countless number of sizes and types. The Memorandum served in 1944 as a means of

Closing Entries.

The closing entries . . . summarize in the income summary account the income, costs, and expenses for the period. By means of these entries, also, the net income (or net loss) is transferred from the income summary account to the proprietor's personal account, and the balance of the latter account may be closed into the capital account.¹²

10. Noble, *Principles*, p. 72.

12. Noble, *Principles*, p. 245.

greater efficiency and accuracy;²² accounting offices today are equipped with adding machines and typewriters for the same purpose. The pen-and-ink bookkeeper of antiquity would be astounded by the almost human nature of the International Business Machine, and his efforts would indeed appear feeble in comparison.

18. Littleton, *Accounting*, p. 362.

19. Littleton, *Accounting*, p. 9.

20. Brown, *The History*, p. 114.

21. Paciolo, *Treatise*, p. 83.

22. Paciolo, *Treatise*, p. 14.

COAST-TO-COAST

(Continued from page 5)

February. A professor of taxes at the University of California, Mr. Surrey is now at work on a project of the American Law Institute to redraft the Federal income tax law.

SPOKANE

Members submitted questions at the February meeting for discussion at the March meeting, at which the speaker was Mary Cooper and the subject *Mining Legislation and Taxes*.

TOLEDO

The chapter discussed the proposed Equal Rights Amendment at the January meeting. Anne Long for the affirmative and Rachel Cooper for the negative led the discussion.

Mrs. Keith Conrad spoke in February on *The Philippines*, where she spent considerable time with the Red Cross during the war.

A discussion of *Internal Control* highlighted the March meeting. The four excellent talks on the subject given at the Chicago annual meeting provided the material.

NEW ASWA MEMBERS

ASWA chapters welcome: *Atlanta*—Marie G. White, Bessie T. Shaw, Mary C. Cleland, Lurline M. Everitt, Mary Kate Johnson, Martha Hyde. *Chicago*—Mary Meek, Elise Mathieu. *Columbus*—Catherine Yount. *Detroit*—Loreice E. Luffy, Anna Romanzin. *San Francisco*—Marilyn M. Davis. *Spokane*—Elizabeth Cummer.



We are fortunate in being able to present to you in this issue an article on fiduciary accounting by Ethleen Lasseter. As trust auditor of The First National Bank of Atlanta, Georgia, and formerly as manager of trust operations, she has had extensive experience in fiduciary work.

This article presents a general discussion of some of the problems involved in accounting for trusts and estates and should be of interest to accountants, bankers and all others who deal with fiduciary matters. It will guide readers to points in their own state laws which should be checked in handling trusts and estates, as well as points which should be adequately covered in drawing wills and trust instruments in order that the real intent of the testator may be carried out.

Miss Lasseter has contributed previously to "The Woman C.P.A." and was at one time its editor. She is a past president of AWCSPA and has served both our societies notably and continuously. Her articles on banking and allied subjects have been widely printed. In 1945 she was chosen as Atlanta's Woman of the Year in Business.

She is a member of the American Institute of Accountants and The Georgia Society of CPAs.

ACCOUNTING FOR TRUSTS AND ESTATES

By **ETHLEEN LASSETER, C.P.A.**

Accounting for trusts and estates is largely a matter of apportioning receipts and disbursements between principal and income. Usually, especially in the larger estates, the residue, or what remains of the gross estate after settlement of debts, claims, bequests, estate taxes and administrative expenses, is left in trust with the income therefrom payable to one class of beneficiaries, commonly referred to as life tenants, and the principal, or corpus, distributable at the death of the life tenant, or at some other designated time, to another class of beneficiaries, commonly referred to as remaindermen.

Consequently, there are two distinct classes of beneficiaries whose separate interests may be properly and impartially served only through proper apportionment between principal and income. The problems involved are many and complex.

Some of the problems arise through improperly drawn instruments. Frequently, wills and trust instruments are silent on a number of important points; or, worse still, contain ambiguous language and conflicting provisions. Problems arise also through inadequate state laws. Fiduciary laws in some states are absolutely silent on apportionment. Therefore, the fiduciary, who may be an individual or a corporation and who may be acting as executor, administrator, trustee or guardian, must

rely frequently upon judgment and discretion in determining the real intent of the testator which is the controlling factor in making apportionment between principal and income. Since the effects may extend generations into the future, extreme caution must be used and, in some instances, it is necessary to petition the Court for direction.

There are two concepts regarding trust administration which should be recognized in any study of accounting for trusts and estates. When the testator who executed the will or trust instrument bequeaths the income from the residue of his estate to a life tenant, his intent is that the life tenant enjoy, as nearly as possible, the same income from these assets that he, the testator, had enjoyed during his lifetime. Also, the life tenant is the primary beneficiary and his interest or welfare, in the absence of specific provisions to the contrary, is the first consideration of the testator.

Those two concepts have long been reflected in legal interpretations of wills and trust instruments, and in court decisions on fiduciary matters. They have also had a pronounced influence upon the exercise of judgment and discretion by fiduciaries. They are reflected too in the Uniform Principal and Income Act which has been adopted with some modifications by 16

states, the widely influential Massachusetts Rule, and in the general practices and policies of fiduciaries in states which do not have adequate laws on apportionment. It is not surprising then to find in frequent instances that apportionment properly made from an administrative standpoint does not conform to the accounting principles applied in making apportionments for other purposes.

ACCRUED INCOME

In estates the first occasion for apportionment is usually in determining what income was accrued at the date of death of the testator, since the corpus of an estate consists not only of property owned by the decedent but also any income accrued on the date of his death. The fact that the items are taxable as income when received does not necessarily make them income in fiduciary accounting. Ledgers and records necessarily are designed to reflect the separate interests of the two classes of beneficiaries.

Accrued interest on bonds is merely a mathematical computation. Stocks held on date of death must be traced to an investment service, or other reliable source, for possible accrued dividends. From the standpoint of the paying corporation, dividends accrue on the date declared, but they accrue to stockholders on the date of record specified by the corporation as the date on which stockholders entitled thereto are determined. Proceeds of interest coupons may be part principal and part income, but a dividend is either principal or income in its entire amount.

Ordinarily rents are payable in advance. In the event the date of death is February 2 and rent due February 1 is unpaid, rent for the entire month of February is accrued on the date of death.

In accruing interest on notes, consideration must be given to the fact that sometimes interest is included in the face amount, in which event a portion of the face amount must be apportioned between income and principal. Distinction may be reflected on ledgers by recording as face amount the total amount payable, and as inventory value that portion of the amount payable that is to be credited to principal cash upon receipt of payment.

Since professional men customarily file their tax returns on a cash basis, accounts receivable in their estates, though taxable as income when collected, are accrued income on date of death, and the proceeds become principal in estate accounting.

Accruing income at date of death presents especially complex problems in the matter of crops growing in fields, and fruit on trees. Values placed on them by appraisers acceptable to the Internal Revenue Department for estate tax purposes usually may be used in estate accounting also.

Interesting situations arise in that respect in connection with orange groves as it is not unlikely that three crops will be involved. In one instance, an estate was comprised largely of a valuable orange grove. On date of death, one crop was in process of being harvested, the next crop was considered by appraisers to be set and therefore to have a salable value at that time, while the third crop was in blossom.

Accrued income with respect to the first crop was determined from records of the growers association which reflected exactly how many boxes had been gathered before date of death and how many were gathered after date of death. The second crop, which was appraised as having a value of \$9,300 on date of death, finally netted \$11,000, of which \$9,300 became principal and the balance income.

The matter of accruing income is involved also in the event of the death of an income beneficiary entitled to income from the trust for the duration of his or her lifetime; also, in making final distribution in proper proportions to two or more remaindermen.

Expenses prepaid by decedents or trustees ordinarily are not deferred as of date of death, or date of distribution.

AMORTIZATION

Amortization of bond premiums and discounts is another item of importance in apportionment between principal and income. The Massachusetts rule, Uniform Principal and Income Act, and fiduciary laws of some states which have not adopted the Uniform Act, provide that the entire amount of interest received shall be treated as income distributable to life tenants, and that any loss or gain realized upon maturity or other disposition, shall fall upon or inure to principal, or remaindermen. That procedure is based largely on the need for some clear, intelligible and workable rule for the treatment of amortization.

In the absence of specific provisions or state law to the contrary, the policy of fiduciaries in regard to amortization in some states is based more on logic, and less on practicality from an operating

standpoint. Premiums on bonds which constituted part of the original inventory are not amortized, following the general concept of trust administration. Premiums on bonds purchased by fiduciaries as investments for trusts are amortized, the theory being that the original estate should be kept intact for remaindermen as nearly as possible and over a period of years premiums on bonds purchased could make considerable inroad on corpus. While not amortizing original inventory items will cause some inroad on corpus, it will result from investments made by the testator, not the fiduciary.

It is paradoxical that policies based on such fine points of logic often lead to complications which necessitate exceptions to rules, and emphasize the need for practicality. In perpetual trusts all premiums may be amortized, whether bonds are original inventory items or purchases, as it is considered that there is a sacred trust to preserve the corpus which quite conceivably over a period of years could be exhausted completely through unamortized bond premiums. In other trusts amortizing premiums would only necessitate useless ledger entries, as is the case with trusts which provide encroachments, or invasion of corpus, for the benefit of life tenants, if encroachments are likely to exceed any possible total of bond premiums. Then, too, in some trusts amortization is prohibited through provisions of the instrument.

There are two other lines of reasoning regarding amortization which are significant. If the remaindermen sustain some loss through premiums not being amortized, it may still be to their advantage as the type of bond that sells at a premium is usually the safest form of investment and thereby a protection to the remaindermen's ultimate inheritance. If life tenants seem to sustain some loss through premiums being amortized, it is not actually the case. In effect, premiums and discounts are merely a means of adjusting interest rates on bonds previously issued to the market price current at the date of purchase.

Customarily, bond discount is not accumulated.

STOCK DIVIDENDS AND RIGHTS

Apportionment between principal and income becomes even more complex with stock dividends, which may be paid in stock of the issuing corporation or of another corporation; also, rights issued,

which may be to acquire additional stock in the issuing corporation, or in another corporation. The same problems are involved in extraordinary cash dividends paid from earned surplus, which may have been earned prior to, or subsequent to, acquisition of the stock; or from proceeds of the sale of capital assets, which is usual with shares in investment trusts. Even ordinary dividends paid from current earnings present problems when depletion or depreciation is of relative importance and, as a result, a significant portion of the dividend is non-taxable.

The Uniform Principal and Income Act provides that all dividends paid in cash, regardless of the source of the funds, shall be income and all dividends paid in stock of the declaring corporation shall be principal; dividends payable in cash or stock at the option of the stockholder, shall be income regardless of the election made; rights shall be principal if they convey the right to acquire additional stock in the issuing corporation and income if to acquire stock in another corporation.

When neither bound nor guided by state law, fiduciaries generally follow somewhat the same policies, giving individual consideration, however, to peculiar circumstances which frequently alter cases.

DISTRIBUTIONS

Distribution of income too, as well as receipt, involves many complex problems. One of the most difficult is the determination of what income is distributable to a widow, for example, who is entitled to the net income on the residue on her husband's estate from the date of death. Net residue may be ascertained only through the determination of the estate tax liability, administrative expenses, debts of the decedent, specific bequests, and all other items chargeable against the general estate. Since the laws of most states allow creditors one year in which to file claims against estates, and the Federal Tax law allows the fiduciary 15 months from date of death in which to file the Estate Tax Return, one year is usually the minimum time in which the exact residue of an estate may be determined, and it may be as much as three years or more. Yet, it is obviously the intent of the testator that his wife be provided with means of support from the date of his death. Therefore it is necessary for the executors to estimate early in the life of estates approximately how much cash will be required and what items will likely be sold to raise the necessary amount. Income on

those items should be withheld by the Executor, and the remainder distributed. In the absence of any provisions or specific law to the contrary, this is essential in order to protect fiduciaries from possible later claims by remaindermen, who eventually will be entitled to receive the residue. At the same time, it may appear to conflict with the general concept that life tenants have a superior equity in the estate over the remaindermen.

Strange to say, The Uniform Principal and Income Act contains no provisions covering this point. The Massachusetts Rule, however, provides that the entire income, under those circumstances, be distributed to life tenants. Certainly, administration of estates would be less complex if income accruing from date of death on all property not specifically bequeathed could be considered as being distributable to life tenants.

A change in the Federal Revenue Act of 1942 created another difficult problem in distributions. Many wills executed prior to the effective date of that act provided that income be accumulated and added to corpus, and that the widow, or other life tenants, receive annuities of stipulated amounts. Income then was taxable to the fiduciary, and the annuities tax free to the recipients. Under the Federal Revenue Act of 1942 such annuities are taxable to the beneficiary, rather than to the fiduciary, in so far as the funds from which the annuities are paid arise from taxable income. That poses the question as to whether beneficiaries are entitled to the amount of the stipulated annuities, over and above the taxes due thereon. If the will provided that the widow receive an annuity of \$10,000, she now would be enjoying the benefit of approximately \$7,700, granting that she had no further income and only one exemption.

One decision has been rendered by a New Jersey court awarding a beneficiary an additional amount annually to cover income tax not foreseen by the testator at the time the will was executed. A Delaware court has rendered an opinion that a beneficiary to whom an annuity of \$6,000 was bequeathed under similar circumstances, was to receive only \$6,000 in spite of the Federal Revenue Act of 1942, even though the will provided for the payment by the trustee of all charges, "including taxes levied or finally assessed."

If the widow who is paying the income tax on her \$10,000 annuity is satisfied, it might be considered that all is well. The

fiduciary, however, must be ever mindful of what his position would be if sometime later, as executor under the widow's will, he should be charged with the responsibility of collecting all amounts due her estate. Such situations, which frequently arise in various phases of trust accounting, present the supreme test of impartiality in justly serving the separate interests of life tenants and remaindermen.

REAL ESTATE

Real estate presents a variety of problems. The most difficult perhaps arises on the sale of real estate of considerable value which had been non-productive or had been operated at a loss for a period of time. The life tenant naturally feels that he is entitled to a portion of the proceeds of the sale to offset his loss in income. Usually in such cases the fiduciary petitions the Court for direction in making any apportionment of proceeds between principal and income.

Customarily net income distributable to life tenants is determined without regard for depreciation. That policy favors life tenants through not only an increase in income distributable to them but also a decrease in the amount of income taxable to them by reason of the allowable depreciation. They may even claim the allowable depreciation on their personal income tax returns even though actually there was no distributable income because of operating losses. Irrespective of the obvious disadvantage to remaindermen, the policy has been upheld by the highest courts and has become established practice.

CONCLUSION

There is no end to the number or variety of the problems involved in accounting for trusts and estates. Limitation of space precludes even mere mention of many of extreme importance. The foregoing discussion, however, illustrates some of the fine points involved and the different angles from which they must be considered.

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Congratulations to the following Ohioans who have passed the CPA examinations: Suzanne Adams, 129 W. Streicher St., Toledo; Mrs. Lillian Widmaier, 1307 Parsons Ave., Columbus; Mrs. Josephine Skodis, 541 East 123rd St., Cleveland. All are members of ASWA.

WHAT'S NEW IN READING

DORRIS C. MICHALSKE, Cleveland, Ohio

AUDIT WORKING PAPERS FOR XYZ CORPORATION, by C. Oliver Wellington. (D. Van Nostrand Co., Inc., New York, 1948. \$12.50.)

Since the public accountant spends much of his time in preparing working papers that are to be the basis of the audit reports to his clients, it is essential that the working papers be well prepared, with information so complete as to leave nothing to question.

This book consists of a complete set of working papers for the annual audit of an imaginary company that manufactures high-grade hand luggage. The firm of public accountants, also imaginary, that prepared the audit has made previous audits for the client. The members of the staff who participated in the audit were the supervisor, a senior in charge, and a junior accountant. The working papers are designed to show the problems most commonly met by the public accountant, and practical solutions to them. The public accounting firm has standardized somewhat the procedures by the use of tabbed printed sheets of instructions and material to be used by the senior in charge for collecting necessary information on the company, for outlining operations, and for planning, assigning and supervising the work. The system is not rigidly standardized, however, and can be adopted to any type of audit program. When filled in, the forms, together with the schedules, lists, and other work sheets, give a completely cross-referenced and orderly story of the work done, who did it, the time required, confirmations of receivables and payables, significant conditions found, etc.

The author is a senior partner of Scovell, Wellington & Company, and a past president of the American Institute of Accountants. In the audit working papers that he has prepared, the practicing accountant will find helpful suggestions for setting up or improving the audit routine of his office, and the student will find realistic material for study.

STATE GOVERNMENT TODAY, by Roy Victor Peal. (The University of New Mexico Press, Albuquerque, N. Mex., 1948.)

This book reviews briefly and appraises the state governments as they are today, their relation to local and federal governments, and how well they are performing

the functions allotted to them. The conclusion reached is the obvious one: that there is an immediate need for reform and reorganization in our federalist system. The three main solutions that have been presented are evaluated by the author. The first is that of the reactionary who would leave the governmental system as it is and decrease federal authority. The second, the evolutionary solution, would make important changes along with changing times. The third proposal would completely reorganize the government into a regional system with the states mere cultural areas.

THE ISSUE OF COMPULSORY HEALTH INSURANCE, by George W. Bachman and Lewis Meriam. (The Brookings Institution, Washington, D. C., 1948.)

An issue that is now before Congress and that is of vital importance to everyone, is the proposal of compulsory health insurance. It is not disputed, of course, that medical care should be made available to those who cannot afford to pay for it. The problem is how to provide more complete medical care for the individual, and to what extent the federal government should act in this respect.

Two major plans have been presented. One leaves the question of health insurance to the individual state and provides grants-in-aid for full medical care for the indigent. The second and more revolutionary plan would result in every employed or self-employed person paying taxes to a health fund, over which the federal government would have entire supervision. The study by The Brookings Institution clarifies the two proposals and delves into the economic, social and administrative problems involved.

The conclusions and recommendations presented in the study were furnished to the Senate Committee on Labor and Public Welfare, which is considering many bills on the subject. In the opinion of the authors, it would be unwise to adopt now, a compulsory health insurance system. Such a system would tend to retard medical progress, they believe; while leaving the question to the individual states and promoting programs of research, health education for both school children and adults, improvement of present physical facilities, and provision of systematic care of the indigent would prove more satisfactory in reaching the objective of a healthier population.

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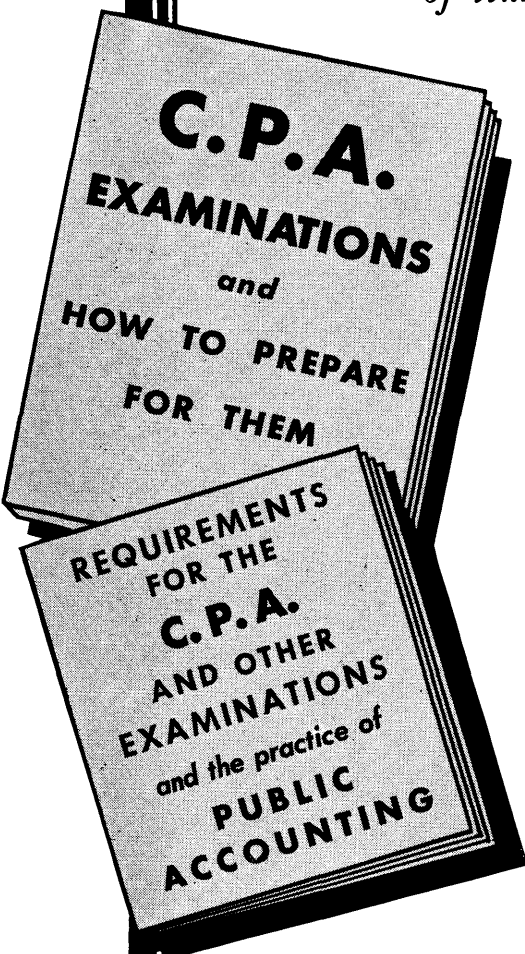
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